ST 01-21
Tax Type: Sales Tax
Issue: Books and Records Insufficient

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	
	)	**Docket No.**
v.	)	**IBT #**
	)	**NTL #**
ABC CO.	)	
	)	
Taxpayer	)	

RECOMMENDATION FOR DISPOSITION

Appearances: Kent Steinkamp, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; John Doe, appearing *pro se* for ABC Co.

Synopsis:

The Department of Revenue ("Department") audited ABC ("taxpayer") for the period of July 1, 1994 to December 31, 1999. During the audit, the taxpayer did not allow the auditor access to its books and records, and the auditor estimated the amount of liability owed by the taxpayer according to the best information available. The Department issued a Notice of Tax Liability ("Notice") to the taxpayer for the additional tax. The taxpayer timely protested the Notice. An evidentiary hearing was held during which the taxpayer's representative argued that because someone from the Department told him that he did not have to collect and pay Illinois sales tax, the liability should be

dismissed. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer's business involves the sale, service, and rental of steam cleaning and pressure washing equipment. The taxpayer is located in Missouri. (Tr. p. 29)

2. The Department audited the taxpayer for the period of July 1, 1994 to December 31, 1999. (Dept. Ex. #2, 3; Tr. p. 10)

3. The taxpayer did not allow the Department's auditor access to its books and records for the audit period. (Tr. p. 11)

4. Because the taxpayer did not provide the records for the business, the auditor estimated the tax liability for the audit period. To do this, the auditor requested the taxpayer's sales tax returns from the Missouri Department of Revenue. (Tr. p. 12)

5. The taxpayer's Missouri sales tax returns for the period of July 1994 through December 1996 itemized the deductions claimed. One of the deductions listed on the returns was "export sales." The auditor assumed these sales were Illinois sales for which no tax was charged. (Tr. p. 13)

6. The auditor had based this assumption on the fact that the taxpayer had performed service work in Illinois. (Tr. p. 21)

7. For the period of January 1997 through December 1999, the taxpayer's Missouri sales tax returns did not itemize the deductions claimed. The export sales were included in the total for all exempt sales. The auditor determined the percentage of export sales to total exempt sales for the period of July 1994 to December 1996 and applied that percentage to the total exempt sales claimed on the returns for January 1997

to December 1999. This was done in order to estimate the amount of export sales for January 1997 to December 1999. (Dept. Ex. #1; Tr. p. 14)

8. The Department prepared a corrected tax return for the taxpayer for the audit period based on the export sales from the Missouri sales tax returns. The auditor determined that the taxpayer owed use tax on the items that were sold in Illinois. The corrected return was admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #2)

9. The taxpayer did not present records from its business indicating that the Department's determination is incorrect.

CONCLUSIONS OF LAW:

The Use Tax Act (UTA) (35 ILCS 105/1 *et seq.*) imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. Section 12 of the UTA incorporates by reference section 4 of the Retailers' Occupation Tax Act (ROTA) (35 ILCS 120/1 *et seq.*). Under section 4 of the ROTA, the Department is required to correct the taxpayer's tax return according to its "best judgment and information." 35 ILCS 120/4. There is no requirement that the Department substantiate the basis for its corrected return at a hearing. Masini v. Department of Revenue, 60 Ill.App.3d 11, 14 (1st Dist. 1978). When the corrected return is challenged, however, the method that was used by the Department in correcting the return must meet a minimal standard of reasonableness. Id.; Elkay Manufacturing Co. v. Sweet, 202 Ill.App.3d 466, 470 (1st Dist. 1990).

Section 4 of the ROTA also provides that the corrected return issued by the Department is *prima facie* correct and is *prima facie* evidence of the correctness of the

amount of tax due, as shown therein. 35 ILCS 105/12; 120/4. Once the Department has established its *prima facie* case by submitting a certified copy of the corrected return into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. Clark Oil & Refining Corp. v. Johnson, 154 Ill.App.3d 773, 783 (1st Dist. 1987). To prove its case, a taxpayer must present more than its testimony denying the Department's assessment. Sprague v. Johnson, 195 Ill.App.3d 798, 804 (4th Dist. 1990). The taxpayer must present sufficient documentary evidence to support its claim. Id.

In the present case, the auditor determined that the taxpayer owes use tax on the items that were sold in Illinois. Generally, the party that purchases an item owes the use tax on it. In this case, however, some of the equipment that the taxpayer sold to its customers was apparently incorporated into real estate by the taxpayer. If a party incorporates property into real estate, then that party is considered to be the user of the property. See Craftmasters, Inc. v. Department of Revenue, 269 Ill.App.3d 934 (4th Dist. 1995) (construction contractor's incorporation of materials into real estate is a use of the materials by the contractor and not a sale of the materials to the contractor's customers). If the taxpayer incorporated the equipment that it sold into real estate, then the taxpayer is the party that owes the use tax on the equipment. If the taxpayer did not incorporate the equipment into real estate but simply sold it to its customers, then the customers would owe the use tax on the equipment. If the taxpayer did not incorporate the equipment into real estate, then the taxpayer may have a duty to collect the use tax from its customers. Because the taxpayer appears to be a serviceperson, this would depend upon the annual average cost of the taxpayer’s merchandise sold.

At the hearing, the taxpayer's only response to the Department's corrected return concerned information that it received from the Department concerning its tax liability. In 1996, the taxpayer's bookkeeper contacted the Department in order to find out whether the taxpayer was required to be registered in Illinois to collect sales tax. (Tr. pp. 24-25) The Department sent the taxpayer "NUC-1 Instructions," which state that if the taxpayer is a serviceperson, then the taxpayer must register if the annual average cost of merchandise sold is 35 percent or more of the total receipts from sales of service. (Taxpayer Ex. #2) After receiving this information, the taxpayer determined that it was not required to register, and the taxpayer included a notice on its invoices that stated that the Illinois sales tax is the responsibility of the purchaser. (Taxpayer Ex. #3).

The taxpayer's contention at the hearing was that according to the information that it received from the Department, the taxpayer did not have to register to collect the sales tax, and therefore the taxpayer should not owe any tax. The assessment in this case was not, however, based on the taxpayer's duty to collect the tax. As the Department's counsel stated at the hearing, the Department based the assessment on the fact that the taxpayer had incorporated equipment into real estate in Illinois. The Department had notified the taxpayer of this in a letter sent to the taxpayer on February 1, 2000. (Dept. Ex. #6, p. 4)

Even though the taxpayer has admitted that it performed service work in Illinois during the audit period (Taxpayer Ex. #3), the taxpayer did not present any documents during the hearing to attempt to overcome the Department's *prima facie* case concerning the tax liability. The Department made its determination based on the best information that was available to it. Without additional information provided by the taxpayer, it

cannot be found that the Department's determination is incorrect. Although some of the taxpayer's purchases may have been exempt for one reason or another, the taxpayer is the only party that has access to the documents that would verify that. Without documents indicating that the taxpayer was not responsible for the tax, it cannot be found that the liability should be dismissed.

Recommendation:

For the foregoing reasons, it is recommended that the Notice of Tax Liability be upheld.

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Linda Olivero
Administrative Law Judge

Enter: August 29, 2001